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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, DC 20554

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IN THE MATTER OF
SIMPLIFICATION OF THE
DEPRECIATION PRESCRIPTION
PROCESS

CC DOCKET No. 92-296

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REPLY COMMENTS
OF THE
MINNESOTA DEPARTMENT OF PUBLIC SERVICE

DATED: JANUARY 21, 1994

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INTRODUCTION

The Minnesota Department of Public Service (the Department) submits these Reply Comments pursuant to the Federal Communication Commission's (FCC or Commission) CC Docket No. 92-296, November 12, 1993, Order Inviting Comments (Order).

In the above-captioned Order, the Commission invited Comments on selected accounts and proposed projection life and future net salvage ranges (basic factors) to be used by local exchange carriers (LECs) regulated under the price cap regulatory scheme. Comments were filed by certain LEC parties in this proceeding arguing that basic factor ranges should be established for all accounts, and basic factor ranges should be modified to reflect current expectations of future lives.

The Commission's decision to adopt the Basic Factor Range (BFR) option for depreciation prescription simplification represents a reasonable approach to balancing the interests of price-cap LECs and ratepayers.

SUMMARY

In its October 20, 1993, Report and Order, the Commission prescribed a methodology for depreciation simplification that it determined would best address the need for a more streamlined and flexible depreciation prescription process, as well as the regulators' and consumers' concerns for necessary oversight of the depreciation process. This is necessary because, without adequate regulatory oversight, LECs may increase their depreciation expenses thereby reducing their rates of return, potentially moving themselves outside the sharing zone currently prescribed by the price cap arrangement.

In response to the Commission's request for Comments, the Commission received a number of proposed modifications, proposed a number of modifications to the Commission's proposed BFR option. These modifications include the expansion of the BFR option to include all accounts, and proposed life ranges that reflect current expectation of future lives.

The Department recommends that the BFR option be limited to the 22 accounts enumerated in the Commission's November 12, 1993, Order in CC Docket 92-296. These accounts are generally small, and the financial impact resulting from acceptance of a range of projection lives should not materially affect an LEC's earnings. Projection lives proposed by LECs must reflect current, as well as proposed, retirement experience. If retirement experience does not support previous projections and projection lives are heavily weighted by an LEC's projections, the recovery of plant-in-service will not match service life, and the resulting increased depreciation expense will reduce any sharing that may result.

The projection lives of LECs' large accounts should be based on proven retirement experience and reasonable retirement projections. The BFR option and the current prescription process provide the proper format to balance the interests of both LECs and ratepayers.

1. BASIC FACTOR RANGES SHOULD BE ASSIGNED TO ONLY THOSE ACCOUNTS DESIGNATED BY THE COMMISSION.

The Commission proposes to establish basic factor ranges for the following accounts:¹

- Motor Vehicles
- Aircraft
- Special Purpose Vehicles
- Garage Work Equipment
- Other Work Equipment
- Furniture
- Office Equipment
- Computer Communications Equipment
- Computers
- Radio
- Circuit DDS
- Circuit Analog
- Public Telephone
- Other Terminal Equipment
- Aerial Cable-Metallic
- Underground Cable-Metallic
- Buried Cable-Non-Metallic
- Submarine Cable-Metallic
- Submarine Cable-Non-Metallic
- Conduit Systems

In its comments, USWC asserts that the 22 accounts adopted by the Commission will cover only 30 percent of its investment and, therefore, will not significantly change existing depreciation procedures.² Consequently, it suggests that this limitation accomplishes little in the Commission's effort to simplify the presubscription process.

¹ CC Docket No. 92-296, Order Inviting Comments, rel. Nov. 12, 1993, Appendix.

² USWC Comments, December 17, 1993, at p. 2.

The Department concurs with USWC that this action will not have a significant impact on the Company, and indeed, as a first step in the simplification process, caution must be exercised. The Commission's plan as set forth in its October 20, 1993 Report and Order to establish ranges for the life and salvage factors of these accounts will avoid extensive examination of life and salvage factors that have very little impact on total depreciation expense.

Reasonable life and salvage factors for these accounts should reflect the LEC's retirement experience. According to USWC, the Commission should expand its ranges to encompass all currently-prescribed lives.³ Studies that support the proposed life and salvage factors are necessary. However, once an LEC supports its life and salvage factor and demonstrates that they fall within the approved range, no further discussion is necessary.

The Commission did not adopt Basic Factor ranges for the following accounts:⁴

- Buildings
- Analog ESS
- Digital ESS
- Step by Step
- Crossbar
- Operator Systems
- Circuit Digital
- Pole Lines
- Aerial Cable--Metallic
- Buried Cable-Metallic
- Intra Building Cable-Metallic
- Intra Building Cable-Non-Metallic
- Deep Sea Cable
- Aerial Wire

In its comments, USWC question this exclusion and explains that the digital switch, digital circuit, and buried cable-metallic accounts make up

³ USWC Comments, December 17, 1993, at p. 6.

⁴ CC Docket No. 92-96 Order Inviting Comments, rel. Nov. 12, 1993, at p.3.

approximately 47 percent of its investment. Further, these accounts are most affected by competition and technological change.⁵ However, it is precisely because of the financial impact engendered by the inclusion of these accounts that renders the Commission's cautious approach appropriate. Initially ranges have been proposed for many of the smaller accounts. Ultimately, ranges will be set for these accounts as soon as possible.⁶

Changes in depreciation expense for these accounts can significantly impact earnings. Not all of these accounts are considered "big" accounts, but their inclusion here appears to be generally due to either their size or their significant retirement activity. For instance, Buildings, Analog and Digital ESS, Circuit Digital, and Buried Cable-Metallic are typically all accounts with large investments. Accounts like Step by Step, Crossbar, Operator Systems, Pole Lines, Aerial Cable-Metallic, Intra Building Cable-Metallic, and Aerial Wire typically are experiencing significant retirement activity, and significant swings in depreciation expense can occur. Such swings are not necessarily inappropriate if they reflect prudent retirement experience, but this must be adequately demonstrated.

Determining the prudence of proposed changes in the life and salvage factors of these accounts merits careful analysis by regulators because of the potential impact on LEC earnings. Regulators are obliged to ensure that proposed life and salvage factors reflect both realistic retirement projections, as well as retirement experience. While regulators have traditionally relied upon historical data, recognition has been given to forward-looking lives unsupported by past retirement experience. In USWC's 1992 Three-Way meeting, lives shorter than those supported by retirement experience were accepted by both the Department and the Commission for digital switch and cable accounts. Such actions are appropriate when subsequent studies confirm earlier retirement projections. Occasionally, studies demonstrate that earlier projections are not supported by subsequent retirement experience. For instance, not all of the proposed 1992 digital switch conversions required by USWC's Incentive Regulation Plan in Minnesota occurred within the anticipated 1992 time frame. These experiences confirm that not all planned retirements and investments will

⁵ USWC Comments, December 17, 1993, at p. 4.

⁶ CC Docket No. 92-96 Order Inviting Comments, rel. Nov. 12, 1993 at p.2.

occur according to schedule. If recovery is too heavily based on such projections, depreciation expense will be too high, and earnings and any sharing of revenues will be too low.

Regulators also have an obligation to ensure that recovery is not too slow. Depreciation must be accurate for the purposes of inter-generational equity, the accuracy of accounting records, and the long-run health of regulated firms. However, the LECs' self-interests are usually served by pursuing expeditious recovery. A balance is therefore struck between LECs and regulators when proposed life and salvage factors are scrutinized in the context of the BFR option and the current presubscription process.

2. THE COMMISSION'S PROPOSED PROJECTION LIFE RANGES REFLECT LEC PLANT RETIREMENT EXPERIENCE, AND SHOULD BE USED TO ESTABLISH BASIC FACTOR RANGES.

In its comments, USWC submits that the Commission's proposed range of lives should be modified to reflect current expectations of future lives, and its proposed lives are consistently shorter than those proposed by the FCC.⁷ Life and salvage factors have been generally established based on regulatory experience. If significant changes in life and salvage factors are proposed based on current expectations of future lives, USWC has generally been asked to compare its recent retirement experience to its retirement projections. If the comparison is close, the proposed changes are generally accepted by the Department.

Disputes arise when there is insufficient retirement experience, and regulators are asked to accept LEC proposals based on unsupported projections. While regulators cannot expect every LEC proposal to be proven by a complete historical retirement study, LECs should not expect regulators to adopt new proposals based largely on unproven future expectations. The decision to adopt the BFR option represents a reasonable approach at simplifying the depreciation

⁷ USWC Comments, December 17, 1993 at pp. 7-8.

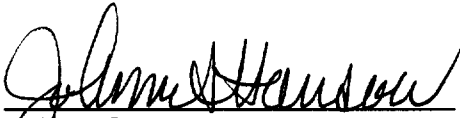
prescription process while maintaining the forum necessary to balance the interests of the LECs and ratepayers.

CONCLUSION

The Commission's decision to adopt the BFR option for depreciation prescription simplification represents a reasonable approach to balancing the interests of price-cap LECs and ratepayers. Initially limiting the number of accounts to the smaller, more non-controversial ones appropriately removes a significant number of accounts from potentially extended debate and permits more time and effort for the larger accounts and accounts subject to greater technological change and competition.

RESPECTFULLY SUBMITTED,

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I, **Linda Chavez**, being first duly sworn, deposes and says:

That on the **20th** day of **January, 1994**, she served the attached
DPS Reply Comments

Docket Numbers: **CC 92-296**

by depositing in the United States Mail at the City of St. Paul, a true
and correct copy thereof, properly enveloped with postage prepaid.

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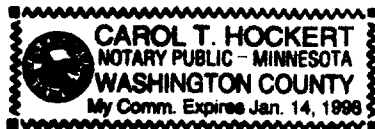
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Linda Chavez

Subscribed and sworn to before me
this 20th day of January, 1994

Carol T. Hockert



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